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Pre-Approved Plan Program Opens to Hybrid Plans, ESOPs

In an effort to increase the availability of pre-approved retirement plans to small and mid-size employers, the IRS recently extended this program to hybrid plans and ESOPs. It also reduced from 30 to 15 the minimum number of employer-clients required for a pre-approved plan sponsor wishing to submit a single basic plan to the IRS for pre-approval. These changes do not affect individually designed retirement plans.

Background

A pre-approved retirement plan is a standardized plan sold to employers by a document provider, such as a financial institution or benefits practitioner that serves as the pre-approved plan sponsor. An individually designed plan, in contrast, is generally drafted to be used by only one employer.

In 2005, the IRS established a system of cyclical remedial amendment periods under the Code. Under this system, pre-approved plans must be submitted to the IRS for a new opinion or advisory letter every 6 years — with pre-approved defined contribution plans filed in one year and pre-approved defined benefit plans filed in another year. Individually designed plans have staggered remedial amendment cycles spread over 5-year periods. (Please see our *For Your Information* articles dated August 6, 2007, March 13, 2007, and September 28, 2005.)

Pre-Approved Plans

There are two types of pre-approved retirement plans: Master and Prototype (M&P) plans and Volume Submitter (VS) plans. An M&P plan consists of a basic plan document containing standard provisions, an adoption agreement containing employer-specific provisions, and a trust or custodial account. A VS plan is a "'specimen," or sample plan, that employer-clients adopt on an identical or nearly identical basis.

Comment. The IRS recently expressed informally its intention to change substantially the individually designed plan determination letter program in 2017. (See our June 30, 2015 *For Your Information*.) Citing insufficient resources to maintain the status quo, the IRS anticipates providing individual determination letters for initial plan determination, upon termination, and for select (but yet-to-be defined) types of amendments — but to cease reviewing interim amendments on a cyclical basis.

In 2011, the IRS updated requirements for obtaining pre-approved plan opinion and advisory letters, specifying in that guidance that opinion and advisor letters would not be issued for hybrid plans (also known as cash balance plans) or Employee Stock Ownership Plans (ESOPs).

Pre-Approval Now Available to Some Hybrid Plans and ESOPs

In an effort to increase the availability of pre-approved plans to small and mid-size employers, in Revenue Procedure 2015-36 the IRS opened the pre-approved plan program to (1) hybrid plans for submission by October 30, 2015, and (2) ESOPs during the defined contribution application period beginning on February 1, 2017. Along with this guidance, the IRS released Listings of Required Modifications (LRMs) that provide sample language for pre-approved hybrid plans and ESOPs.

Hybrid Plans

In addition to the M&P and VS provisions set forth in the 2011 guidance, cash balance plans must meet certain other requirements to receive favorable IRS opinion letters. Specifically, to comply with the anti-cutback provisions of Section 411(d)(6) that protect prior benefit structures, pre-approved hybrid plans must "provide that, at all times, prior accrued benefits (and other benefits protected under Section 411(d)(6)(b)) are protected."

Additionally, hybrid plans that contain any structures of principal credits that increase with age, service or another measure during a participant's employment must be "definitely determinable, operationally nondiscriminatory, and at all times in compliance with the '133 1/3 percent rule' of Section 411(b)(1)(B)," and associated regulations.

Although hybrid plans are now eligible for the program with the restrictions noted above, certain plan features shut the door on pre-approved plan status, including:

- PEP formulas
- Interest credits based on participant choice
- Interest rates based on the actual rate of return on plan assets or a subset of plan assets or a regulated investment company (for example, a mutual fund)
- Certain offset designs

ESOPs

Some additional requirements apply to ESOPs, as well. To receive a favorable advisory letter, an ESOP must include:

- A statement that the plan is an ESOP within the meaning of Code Section 4975(e)(7), designed to invest primarily in employer stock
- A provision defining employer stock as either common stock issued by the employer (or a member of the employer's controlled group) that (1) is readily tradable on an established securities market, or (2) has a combination of voting power and dividend rights greater than or equal to the class of employer common stock with the greatest voting power and dividend rights

- Provisions that meet certain diversification, valuation, independent appraiser, allocation of earnings, voting, demand and put options, distribution, exempt loan, limitations on contributions, S corporation, and C corporation requirements

ESOPS combined with money purchase plans and those that hold preferred stock are not permitted to use the pre-approved program.

Fewer Adopting Employers Needed, Submission Deadline Extended

Prior rules required a pre-approved plan sponsor to represent to the IRS that it has at least 30 employer-clients in the aggregate, each of which is expected to adopt at least one of that sponsor's plan documents. This guidance reduces from 30 to 15 the number of employer-clients a sponsor wishing to submit a single basic plan document must represent to the IRS are expected to adopt the plan. If a sponsor requests an opinion letter for more than one basic plan document, however, it must represent that it has at least 30 employer-clients in the aggregate, each of which is reasonably expected to adopt at least one of the sponsor's basic plan documents.

Additionally, the guidance pushes back the deadline to submit on-cycle applications for pre-approved defined benefit plan opinion and advisory letters to October 30. The previous deadline was June 30.

Still Not Allowed

Unchanged is the ban on using a pre-approved plan for certain types of sponsors and plans, including:

- Governmental and non-electing church plans
- Multiemployer plans
- Plans with Section 401(h) medical benefit accounts
- Certain pooled funding arrangements under Rev. Rul. 81-100
- Combination defined benefit and defined contribution plans under either Section 414(k) or 414(x)(2)
- Non-safe harbor target benefit plans
- Defined benefit plans with employee contributions (other than hybrid plans that discontinue those contributions)
- Plans that incorporate certain qualification rules by reference (Section 415, ADP, or ACP tests)
- Plans that use non-safe harbor procedures, such as for hardship distributions

In Closing

The expanded availability of pre-approved plans may be attractive to small and mid-size employers. Large employers, on the other hand, typically prefer the greater choice and flexibility that individually designed plans can offer.

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